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THE LATIN AMERICAN FREE TRADE ASSOCIATION

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18 October 1963

THE LATIN AMERICAN FREE TRADE ASSOCIATION

The Latin American Free Trade Association (LAFTA) is currently in session to negotiate a third annual round of tariff reductions on intraregional trade. The LAFTA treaty envisages the elimination of tariffs on "substantially all" intraregional commerce by 1972. The treaty indicates that this will be a step toward the eventual formation of a continental common market, although LAFTA so far has made little progress in this direction. The prospect of regional integration, however, has not only stirred the imaginations of economists and businessmen; it has sparked the interest of political leaders, who perceive possibilities of developing LAFTA as a vital force for extending Latin American influence in world councils.

Economic Background

LAFTA is part of a wider movement toward economic regionalism. Like the visions which gave rise to the European Economic Community, the European Free Trade Association, and the Central American Common Market, the concept of LAFTA took root in the 1950s. The rationale for LAFTA, as for the other regional systems, was that big industries on the American pattern could develop only if the size of the market was also on the American scale.

The case for a Latin American economic region took on urgency after the middle of the decade, when the break in prices of coffee and other key commodities finally cracked the postwar boom. Economic projections indicated that foreign demand for coffee, copper, tin, and other traditional exports would not sustain a satisfactory rate of economic growth in Latin America. The situation seemed to call for new trade patterns based on the establishment of new industries.

The two remedies--expansion of intraregional trade and creation of new industries--logically went hand in hand. Ecuador could hardly sell much coffee to Brazil. In the absence of new industries, the economies of the different countries would not be sufficiently complementary, and the growth of intraregional trade beyond a certain point would take on the absurd caricature of countries taking in each other's washing. Nevertheless, it was not politically possible to take more than one cautious step toward economic union; the LAFTA treaty signed in Montevideo in February 1960 centered on the promotion of intraregional trade, with only peripheral attention to the establishment of new industries.

The LAFTA Treaty

The Treaty of Montevideo specifies a sequence of negotiations that will hopefully lead, over a 12-year period, to establishment of a free trade area for most products. The main characteristic of this area will be the virtual elimination of tariffs and other import restrictions against goods originating in any of the participating countries. The treaty does not stipulate any steps toward completing the customs union by the establishment of a common tariff wall. National tariffs continue to govern against imports from outside countries.

During the 12-year transition period, the treaty allows for variations among the LAFTA countries in the items selected for tariff reduction. The governing rule is that the average duty collected by each LAFTA member on intraregional trade be a stipulated percentage lower than the average of duties collected on imports from third countries. This differential, set at 8 percent the first year, is to widen by successive 8-percent increments each year. The tariff cuts are not automatic at each stage, nor are they across the board. They are rather to be negotiated item by item in annual LAFTA conferences. There is no certainty that the negotiations will be invariably successful.

It is not obvious at first reading, but what the treaty provisions come to is that the signatories have to negotiate tariff cuts only on items they are already importing from each other. The encouragement to new industries is minimal, since they have no assurance of getting the tariff preferences that would open up the whole regional market.

Results

LAFTA may take a shape more substantial than the treaty provisions outline. The first round of tariff reductions in 1961 effected a differential between intraregional and external tariffs well in excess of the prescribed 8 percent. The signatories also went beyond the treaty provisions in extending tariff reductions to items not yet included in intraregional trade.

These concessions may have had a modest impact on trade patterns. The 1962 trade statistics showed a decline in LAFTA imports from outside countries but a rise of 17 percent in intraregional commerce. Mexico made the most striking gains. Mexican exports to the rest of the region doubled; Mexico's chemical exports to the region went up more than 400 percent. However, over nine tenths of LAFTA's foreign commerce is still with nonmember countries (see chart).

The second round of tariff reductions in the summer of 1962 came harder, as the countries ran out of items on which they felt they could make concessions without jeopardizing national interests. The third round, now being negotiated, may well be the acid test, indicating whether or not LAFTA is to develop into a truly regional economic system. Even after tariff concessions are negotiated, there are escape clauses, permitting signatories to reimpose import restrictions in the event of balance-of-payments disequilibrium or to avert difficulties with such important political elements as domestic farm lobbies.

Appraisal

The treaty has been in force since 1961, too short a time for definitive appraisal. LAFTA's present goals, limited though they are, could prove to be out of reach because of political instability. Chronic inflation may impose another restraint on economic cooperation. The cost-of-living index in Brazil, for example, went up about 50 percent in the first nine months of this year. Rising prices weaken the competitive position of domestic producers and bring greater pressures against tariff reduction. However, if the present limited

PRINCIPAL ORGANS OF LAFTA

Conference of the Contracting Parties: Supreme organ of the Association. Composed of delegations from member countries, meeting in regular session each year.

Permanent Executive Committee: The Association's standing body, which supervises implementation of the treaty. It has no decision-making or enforcement powers beyond those that may be delegated by the Conference.

Executive Secretary: Elected by the Conference every three years, he has no formal powers but heads a Secretariat of technical and administrative personnel. He and the Secretariat are enjoined by the treaty to act as international civil servants, neither seeking nor receiving instructions from the member governments.

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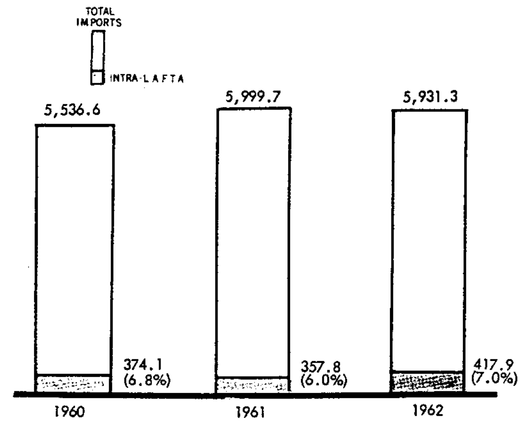
TRADE OF LAFTA COUNTRIES
(IN THOUSANDS OF DOLLARS)



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goals of tariff liberalization are realized, the LAFTA treaty suggests that more ambitious objectives of economic integration will be pursued. In the meantime, the consultative machinery has been set up for a working regional system (see inset).

Although trade promotion is the main thrust of the Montevideo Treaty, Article 16 provides for some encouragement also to industrial development on a regional basis. So-called complementation agreements are authorized among the member countries to achieve industrial complementarity, i.e., specialization in certain industries. It is expected that most of these agreements will ensure tariff preferences for the industries affected. A few may take on cartel-like arrangements.

The progress of industrial complementarity depends in large part on how competitive new Latin American industries can be against traditional supply sources. The treaty itself does nothing to promote new railroads and highways across the mountains and jungles of Latin America. As long as overland transport costs are high, the economies of ocean carriage from the US and Europe may prevail against the tariff preferences and other advantages accorded by the complementation agreements.

Credit facilities constitute another lack which the Montevideo Treaty does nothing to overcome. Terms of credit can be as crucial to a Latin American buyer's decision as price differentials. The advantage here lies with the US and West European manufacturer, who can borrow and in turn extend credit on comparatively liberal terms. A Latin American regional bank has been proposed which would make comparable credit facilities available to LAFTA businessmen, but the bank is still in the talking stage.

Beyond the problem of credit facilities for private businessmen, there has been some discussion of arrangements along the lines of payments union for clearing the debit and credit balances among central banks arising from intra-LAFTA trade. Proposed arrangements include stand-by credits to central banks to carry them over periods of deficit in their balance of payments. Here again the proposals are not near the point of adoption.

Political Implications

The US, the principal trading partner of the region, is on record in favor of Latin American programs for economic integration. If these are successful, the machinery requirements of new Latin American industries and the elevation of popular living standards should have the effect of enlarging US trade with the area despite the considerable increase in intra-LAFTA commerce.

At the same time, the US will have to contend against a certain Latin American inclination to maximize whatever leverage LAFTA can muster against foreign business interests. At last year's LAFTA conference, Mexico proposed controls on foreign investments with a view to keeping ownership of new industries in the hands of member states. The Mexicans do not seem to be out to exclude American capital entirely. They prefer to attract it on terms that would in practice require US businessmen to work through Latin American principals, preferably Mexican.

The Mexican proposal reflects a widespread chauvinism within LAFTA that views the organization as a potentially strong bargainer against the US, the EEC, and other continental systems. The political potential is considered to depend on the organization's geographic extent, which ultimately is to encompass all the

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Latin American countries from the Rio Grande to Cape Horn. So far, it includes nine of these countries (see map). One of the gaps is Central America, where five countries have formed their own common market. It is now envisaged that the two regional systems will proceed toward economic integration at their own pace, but that eventually Central America will link up with LAFTA. Panama, which is at present not a member of either system, is expected to associate with the Central American Common Market.

On the South American continent, there are two holdouts, Venezuela and Bolivia. Wage levels in oil-rich Venezuela are higher than in the other countries, and Venezuelans have been dubious about their ability to compete without tariff safeguards. Still, the Venezuelans are far from dismissing the idea of eventual membership in LAFTA. They attend LAFTA meetings as observers and discuss the possibilities of specializing in industries where labor costs are not a high proportion of total costs, e.g., plastics and synthetic fibers. When the presidents of Venezuela and Colombia (a LAFTA member) met at San Cristobal in early August, they issued a communiqué affirming the desirability of gradual economic integration between the two countries. It was agreed that they would coordinate their economic development plans and would promote studies on the possibilities of closer association.

Bolivia's reservations about joining LAFTA may also dissolve with time. About a fifth of Bolivia's imports come from the LAFTA countries, which take only 3 percent of Bolivia's exports. Bolivians are fearful that the balance-of-payments disequilibrium would be aggravated by any leveling of tariffs. Sentiment in favor of joining is nevertheless widespread in La Paz. Like the Venezuelans, the Bolivians have attended LAFTA meetings as observers.

Cuba would like to join. Before the Castro takeover, some 70 percent of Cuba's trade was with the US; trade with LAFTA countries was negligible. Castro now sees opportunities in LAFTA to develop new commerical links and to expand his political prestige in the area. The Cuban bid for membership was voted down at the LAFTA conference in Mexico City last year, Brazil and Mexico abstaining. A factor in the voting was the general understanding that US assistance through AID and the Inter-American Development Bank could not be given to any regional program that included Cuba.

The Cuban vote struck home the fact that LAFTA is not just an economic grouping but also a system with an evolving political character. The foreign minister of Uruguay, [redacted] indicated his view that LAFTA was now too important to be left to the economic technicians. A three-man committee would be set up in the foreign office, he said, to give political direction to Uruguay's LAFTA delegation.

Some Latin American leaders have also urged that a council of foreign ministers be organized in LAFTA to modify its predominantly economic orientation. This interest in LAFTA's political potentials draws on the successes of the European Economic Community and reflects the widespread aspiration among Latin Americans that they too can win greater international stature on the basis of regional cohesion. For the present, however, LAFTA embodies mainly this aspiration, not any record of achievement approaching that of the European Community.

If, as many observers expect, the current round of tariff negotiations in Montevideo yields unimpressive results, LAFTA's importance will continue to be a derivative of its longer range potential rather than any present vitality as an economic and political force in Latin America.

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